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July 11, 2000

Magalie Roman Salas
Secretary
Federal Communications Commission
445 12th Street, SW
Washington, DC 20554

Re: CC Docket No. 96-98 (*UNE Remand Proceeding*)

Dear Ms Salas:

On June 13, 2000, SBC Telecommunications, Inc. ("SBC") filed a letter in the above-captioned proceeding addressing the Commission's reconsideration of its decision to restrict the availability of local switching as an unbundled network element ("UNE") in the top 50 MSAs to customers with three or less lines.[1] A major focus of the SBC Ex Parte concerned evidence submitted by the PACE Coalition[2] that demonstrated that local entrants would be impaired from effectively serving the small business market without access to unbundled local switching (ULS). As the SBC Ex Parte correctly observed, the PACE Coalition analysis[3] is based on

1 Letter from Gary Phillips to Magalie Roman Sales, Secretary, Federal Communications Commission, CC Docket No. 96-98, June 13, 2000 ("SBC Ex Parte").

2 The PACE (Promoting Active Competition Everywhere) Coalition was formed to establish the necessary conditions to support the widespread local competition envisioned by the Telecommunications Act of 1996, in particular for the average residential and small business consumer. PACE members include Birch Telecom, Z-Tel Communications, TALK.Com, Excel Communications, network intelligence, inc., Info Highway Communications, and MCG Credit Corporation (an investment firm that finances local entry).

3 This analysis is also referred to as the Birch Analysis because it was originally filed by Birch Telecom in its Reply to Oppositions to its Petition for Reconsideration in this proceeding. Reply of Birch Telecom, Inc. to Oppositions to its Petition for Reconsideration, CC Docket No. 96-98, filed April 3, 2000.

estimating the economic crossover at which a customer is sufficiently large to serve using high-speed digital facilities (i.e. a DS-1 or T1) instead of individual analog lines.

The economic crossover estimated by the PACE Coalition occurs at approximately 20 lines. That is, when a customer has 20 or more analog lines, it can be efficient to install equipment at the customer's premise to digitize and concentrate its traffic, transport that traffic using a DS-1 loop purchased from the ILEC, and serve the customer using local switching capacity provided by the CLEC. As the Coalition explained, unless the Commission ensures that entrants have access to ULS (and, therefore, UNE-P) to serve customers with up to 20 lines, it will create a "lost market" of residential and small businesses that will be foreclosed from competition and remain captives of the ILEC.[4]

The SBC Ex Parte raised of number of objections to the PACE Coalition's economic and legal analysis. As explained below, SBC's objections are unfounded and do not challenge, in any credible way, the factual basis of the recommendation that the Commission revise its restriction on the availability of ULS to 20 lines or more in the top 50 MSAs.

Before turning to the specific issues raised in the SBC Ex Parte, however, it is useful to point out that SBC fundamentally misunderstands the Coalition's basic position as well as the relevant impairment standard adopted by the Commission. As characterized by SBC "...the central premise of PACE's position is that switched-based competition for customers with DS-O loops is *inherently* impossible..."[5] This mischaracterization is essential to SBC's argument because SBC's substitute theory is that the mere existence of *any* competition using individual UNE loops is proof that competition is not *impossible* and, if not impossible, impairment must not exist. As the Commission is well aware, however, impossibility is not the relevant standard, impairment is. The PACE Coalition recognizes that there is some competition occurring using UNE loops obtained individually. Nevertheless, this competition is commercially insignificant.

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4 Although the current three line ULS restriction is frequently associated with foreclosing competition in the small business market, the Commission should also appreciate its significance for *residential* competition. Like all local entry strategies, carriers preparing to use UNE-P incur substantial investment costs developing back office systems, as well as the marketing and other organizational expertise unique to local entry. Although some carriers (for instance, Z-Tel and Excel) will focus on the residential market, others will come to the residential market as an *extension* of their activity in the small business market, achieving scope economies leveraging back-office systems and local market knowledge. Offering services in both the residential and small business markets is likely to become even more common as competition forces prices towards equilibrium because these entrants' dominant rival (the ILEC) recovers the cost of its infrastructure in both markets. Consequently, the Commission should anticipate that a prerequisite to effective residential competition will be entry in small business market, which will facilitate additional residential competition because it will justify the systems investment needed to serve both.

5 SBC *Ex Parte*, page 2 (emphasis in original).

The negligible entry cited by SBC[6] does not disprove the Coalition's larger point – that is, that widespread, mass-market competition is significantly impaired without access to ULS to serve those analog customers that are simply too small to justify a migration to a high-speed digital connection.

Manual Migration Constitutes Impairment

The Coalition has previously explained that the manual processes needed to migrate individual analog loops (given the prevailing ILEC architecture of "dumb" MDFs) increase entrants' costs and materially diminish their ability to offer service. SBC attempts to refute this conclusion with two arguments. First, SBC claims that the Coalition's comparison of the cost of a manual loop-to-port migration (which is necessary when loops are provisioned individually), to the electronic migration made possible by UNE-P lacks "probative value" and is not "representative" of the industry as a whole because there is no explanation as to why the analysis examined the States that it did. The reason these States were chosen was because these were the States the Coalition was aware of that had determined a cost-based rate for an electronic migration. As Table 1 shows, while there is variation among States on the level of cost (for both manual and electronic processes), the comparison consistently demonstrates that electronic migrations are substantially more efficient:

State	Electronic Migration	Manual Migration	Percent Reduction in Cost
Georgia	$2.01	$113.07[7]	98.2%
Florida	$1.46	$178.00	99.2%
Michigan[8]	$0.35	$35.89	99.0%
New York[9]	$3.82	$67.18	94.3%

Given the consistency across these States, the PACE Coalition believes that its principal conclusion – i.e., that a manual loop-to-port migration imposes substantial costs that can be avoided through electronic means – *is* representative across the industry. Further, SBC's

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6 Consider, for instance, the Commission's most recent Local Competition Report (August 1999, Table 9.4) which shows that UNE loops have not yet achieved a 1% market share in any State other than Nevada.

7 Includes an additional charge for a coordinated hot cut.

8 SBC also claims that the $0.35 charge established by the Michigan Public Service Commission replaces line connection charges, but not service order charges. This is an accurate representation of SBC's *position*, but not, in the Coalition's view, the *decision* of the Michigan PSC. This issue is currently before the PSC in Docket U-11831, which is expected to be decided shortly.

9 It is unclear whether this charge was the product of a cost analysis reviewed by the New York Public Service Commission, or whether it is simply a rate that was adopted as proposed by Bell Atlantic without review by the PSC.

evaluation of these additional costs systematically evaluates only half the issue – that is, SBC discusses only the additional non-recurring costs imposed by the ILEC in its charges for the loop. This architecture, however, requires both a loop *and* port appearance in the central office, as well as cross-connection. As an estimate of the CLEC's non-recurring cost of the port-appearance, the Coalition comparison used the non-recurring charge for a port. Because this charge (if calculated correctly as TELRIC) should be the non-recurring cost of a "generic" efficient provider, this is the best available estimate of an efficient CLEC's own non-recurring cost.[10]

Second, SBC claims that the additional costs of manual "hand-crafting" do not constitute impairment. In support of this argument, SBC makes two points:

* The costs of manual provisioning are only one cost difference between UNE-P and self-provisioned local switching; and

* The Coalition's focus on additional costs is "flagrantly inconsistent" with the Supreme Court's decision.

With respect to SBC's first point, it is correct that these additional provisioning costs are "only one component" of a cost comparison between providing mass-market services using ULS and self-provisioned local switching. What SBC ignores, however, is that the remaining cost components – i.e., the costs of local switching, backhaul, and interoffice transport – are likely to be higher for an entrant than the incumbent.[11] Consequently, while there *are* other cost components that could be considered, the fact that the Coalition analysis assumes that the entrant can achieve the same scale efficiencies as the ILEC simply means that the Coalition analysis *underestimates* the level of impairment.

With respect SBC's claim that the Coalition analysis "flagrantly disregards" the Supreme Court's *Iowa Utilities Board* decision, nothing could be further from the truth. It is simply not accurate (as SBC claims) that the Supreme Court rejected the view that higher costs can constitute an impairment.[12] The Supreme Court merely concluded that a trivial increase in cost

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10 For instance, SBC's Attachment B indicates that the non-recurring cost of a "hot cut" in California is $18.88 (for one line). However, this amount includes only the cost of the loop component. To this cost must be added the non-recurring costs incurred by the entrant to establish the port appearance at the cross-connect. Because an appropriate TELRIC study would estimate the forward-looking costs of an efficient entrant, a suitable estimate of an entrant's cost would be the TELRIC-based non-recurring charge of the ILEC. In California, this would add an additional $7.98 per loop-to-port migration.

11 There is no evidence to conclude that switch manufacturers provide steeper discounts to entrants than to their largest customers, the ILECs. Further, there are substantial, well-documented economies of scale in the interoffice network that are enjoyed by ILECs because of their monopoly (or near monopoly) position.

12 SBC Ex Parte, page 5. SBC goes so far as to misquote the Supreme Court, twisting its analogy of ladders and lightbulbs by claiming that the Court "...noted that if a person could change a lightbulb by standing on a stack of books and fully extending its arm, he

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may not rise to the level of impairment if it carried no market significance. The direction from the Supreme Court was not that cost is unimportant, only that the increase in cost must have a material impact. Moreover, the Court recognized that even a small increase in cost *would* constitute impairment if the market were sufficiently competitive.[13] The PACE Coalition has no ability to accurately predict *equilibrium* revenues, particularly when its members (and others) will use UNEs to offer multiple services -- local, long distance, and information services/access to name a few – making any direct comparison impossible. What we do know, however, is that with the ability to use ULS (and UNE-P) to serve residential and small business customers, competition will quickly drive retail prices to their underlying cost.

It is this point – on the *degree* of impairment – that the Coalition has focused its analysis. We have empirically demonstrated that the provisioning difficulties inherent in providing UNE loops imposes on entrants significant additional costs – costs that are avoided in their *entirety* by an ILEC positioned to simply retain the customer -- that can be substantially reduced (by well over 90%) with access to ULS, and thus UNE-P. As explained below, the competitive landscape changes significantly when these costs (and manual systems) are avoided in markets where UNE-P has become available.

Finally, it is important to note that these additional migration costs are not the only impairments caused by manual provisioning systems. As the Commission is well aware, these manual hot-cut processes are routinely plagued with problems that affect the quality and reliability of CLEC services.[14] The additional migration costs documented by the Coalition are only one factor, but they are an important factor that can be easily quantified.

MARKET EVIDENCE CONFIRMS (NOT CONTRADICTS) THE LEVEL OF IMPAIRMENT

In addition to its more theoretical discussion as to why entrants are not impaired without access to unbundled local switching, SBC claims that "market evidence" demonstrates that carriers can compete even if they are limited to purchasing UNE loops or using their own facilities. In support of this conclusion, SBC offers three observations:

* CLECs have installed switches;

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was not impaired without access to a ladder that would make the job easier." More accurately, the Court concluded that such an arrangement *would* constitute impairment, but that if the distinction was between two ladders, one a half-inch taller than the other, *then* the impairment might not exist.

13 Specifically, the Court reasoned that in a world of perfect competition, in which all carriers are providing service at marginal cost, the Commission's equating of increased cost (or decreased quality) with "necessity" and "impairment" might be reasonable; but the Commission has not established the existence of such an ideal world.

14 The Coalition will file additional information shortly that summarizes these additional problems associated with manual loop provisioning.

* SBC has seen an increase in the number of FDT (Frame Due Time) migrations;[15] and

* AT&T has purchased a cable company.

The Coalition acknowledges that CLECs have, in some markets, self-provisioned local switching. Indeed, Coalition members themselves use non-ILEC switches where it makes economic sense to do so. For instance, Birch Telecom has installed two local switches, while InfoHighway leases local switching capacity from a non-ILEC provider. The existence of these switches proves nothing without an understanding of the market that such facilities are used to serve. Both Birch and InfoHighway use their switches to serve customers with DS-1 volumes (or above).[16] SBC's observation that there are switches being installed is irrelevant to the point of the Coalition's analysis – we freely acknowledge that there exists the possibility of self-provisioning switching in the largest MSAs for the largest customers. The issue concerns the usefulness of those switches in providing mass-market service, a market we have shown can best be approximated by analog customers with fewer than 20 lines.

The fact is that switch-based (i.e., UNE loop-based) competition is effectively limited to serving large business customers desiring high-speed digital service is confirmed by a recent WorldCom filing.[17] As WorldCom explained, it primarily serves customers that have *already* migrated to digital services using PBXs to convert analog lines to digital format. WorldCom is able to serve these customers with T1 or ISDN-PRI access arrangements because they connect to PBXs that provide analog-to-digital conversion and aggregate the traffic of 30 or more lines.

Moreover, SBC's understanding of local market conditions as explained in its Ex Parte is fundamentally different than that expressed in its recent Section 271 application to provide interLATA service in Texas. Although in its Ex Parte SBC expresses skepticism that local competition is focused on DS-1 and above customers,[18] its sworn affidavits in the Texas Section 271 proceeding evidence a clear understanding that competitive conditions are quite different for larger customers with 20 lines or more:

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15 SBC Ex Parte, page 4 and Attachment C.

16 In addition, even a cursory examination of traffic patterns indicates that interconnected CLEC switches are used predominantly to serve the emerging Internet market. While this is a critically important segment of the local market, the existence of CLECs using self-provisioned local switching to serve *this* market segment does not prove, as SBC implies, that CLECs seeking to more broadly serve analog customers are not impaired without access to ULS.

17 *See* Letter from Chuck Goldfarb, to Margalie Roman Salas, Secretary, Federal Communications Commission, CC Docket No. 96-98, June 21, 2000.

18 *See* SBC Ex Parte at page 3.

> SWBT recommends the use of the CHC [coordinated hot cut] process *when 20 or more UNE loops* are to be converted at a single end user's address ... The CHC process is normally necessary only *for larger size business customers where the amount of existing competition is much greater.*[19]

The significance of SBC's sworn affidavit cannot be overlooked. Not only does SBC recognize the highly disparate levels of competition for "large" and "small" business customers, but it confirms that the breakpoint between these markets is the 20-line threshold that the Coalition has shown is the boundary between analog and digital service.

The overall theme of SBC's "numeric" argument is that the mere existence of *some* UNE loop-based competition is sufficient to prove that carriers are not impaired without access to ULS. Although SBC points to the increasing number of FTD hot cuts as evidence that competition is "possible" without access to ULS,[20] SBC completely ignores the relative *scale* of these orders compared to the competition generated by UNE-P. For instance, while SBC touts FDT volumes of roughly 2,124 lines/month,[21] the commercial activity made possible by UNE-P *is more than ten times that amount* (22,925 month).[22] In addition, the lines gained by entrants (for instance, the 2,124 lines/month gained using UNE loops alone) represent the *total* competitive inroad into both new *and* existing lines (which, in Texas, is roughly 9.4 million lines),[23] while SBC is *adding* roughly 13,000 lines/month.[24]

It is impossible to conclude from SBC's "competitive statistics" that the level of UNE loop activity has any commercial significance. The only meaningful conclusion that can be gleaned from these statistics is the 90% reduction in competitive activity that would result from the removal of UNE-P based forms of competition. By any measure, such impairment is

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19 Reply Affidavit of Candy R. Conway, In the Matter of SBC Communications Inc., Southwestern Bell Telephone Company, and Southwestern Bell Communications Services, Inc., d/b/a Southwestern Bell Long Distance for Provision of In-Region InterLATA Services in Texas, Texas Public Utility Commission, CC Docket No. 00-4, paragraph 42(citing Conway Affidavit, paragraph 79), (emphasis supplied).

20 SBC Ex Parte, page 4 and Attachment C.

21 SBC Ex Parte, Attachment C (average for December 1999 through May 2000). The highest volume month (May 2000) was 2,629 lines.

22 Supplemental Joint Affidavit of Candy R. Conway and William R. Dysart, CC Docket No. 00-4, page 16. UNE-P volumes are averaged for December 1999 and January 2000 (the two months of current data provided in the Affidavit).

23 Source: SBC's Response to the FCC's Local Competition Survey, data as of June 30, 1999.

24 Source: SBC's Response to the FCC's Local Competition Survey. Average monthly growth in lines between December 31, 1998 and June 30, 1999 (the most recent months available).

significant and substantial, and provides clear evidence that lack of access to UNE-P would "materially diminish a requesting carrier's ability to provide the service it seeks to offer."[25]

Further, SBC (of all ILECs) should be aware of the critical need to access ULS/UNE-P to serve mass markets. SBC purchased Ameritech precisely because (it then argued) it needed to be able to serve the top 50 MSAs and, absent the merger, it could not enter these markets on its own. As explained by one of its senior vice presidents:

> [W]hat I am telling you is we're [SBC] not going to go into a de novo entry to evolve into a national local company. It would be a death march in our opinion.[26]

Significantly, SBC's post-merger plans to enter out-of-region markets included plans to serve large business customers, data customers, and the small-business/residential market. While the details of those plans are proprietary, the public record indicates that SBC intends to serve the last of these markets (i.e., the small business and residential market) using ULS/UNE-P.[27] Thus, where its own business interests are at stake, SBC has reached the same conclusion as the members of the PACE Coalition – the small business/residential market can only be commercially addressed with access to ULS.

Finally, SBC tries to dismiss the significant impairment caused by the manual provisioning of loop-at-a-time entry with the observation that if "... the hot cut process impairs CLECs from using their own switches [to serve mass markets], the AT&T's strategy [to try and develop cable telephony] would have to be a colossal mistake."[28] On the one hand, we agree with SBC that the "cable strategy" will impose on AT&T a number of manual processes that are at least as severe as the "hot cut" process. However, there is no evidence that the "cable option" is practical in the small business market at issue here, nor is there any evidence that the strategy itself is not a mistake. More to the point, even if the strategy were to prove successful, it does not lessen the impairment that the Coalition's members (and every carrier like them) experiences in competition with the ILECs.

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25 Third Report and Order and Fourth Further Notice of Proposed Rulemaking, CC Docket 96-98, para. 51.

26 Testimony of James Kahan, SBC Senior Vice President, before the Ohio Public Utilities Commission, Case No. 98-1082-TP-AMT, Tr. 176-177, January 7, 1999.

27 *See* Rebuttal Testimony of Joseph Gillan before the Illinois Commerce Commission, Docket No. 98-0555, and Deposition of James Kahan, Public Utilities Commission of Ohio, Case No. 98-1082-TP-AMT.

28 SBC Ex Parte, page 3.

THE BIRCH ANALYSIS PROPERLY (AND CONSERVATIVELY) ESTIMATES IMPAIRMENT

In addition to its general observations concerning impairment, SBC offers a number of specific criticisms of the Birch Analysis. Specifically, SBC claims that the Birch Analysis incorrectly calculated the crossover because the Birch Analysis:

* did not use representative collocation costs;

* did not consider using an alternative to collocation, such as special access;

* inappropriately considered collocation cost as a "loop-by-loop" expense; and

* incorrectly applied SBC's nonrecurring charges.

With respect to the first three of these points, SBC fails to appreciate just how conservatively the Birch Analysis approached the question of collocation costs. It is important to understand that because of the excessively optimistic fill factors and amortization assumptions used in the Birch Analysis, collocation costs are insignificant. In the real world, however, a CLEC would not achieve such high fill factors for many years, while its actual cost of capital would be much higher (due to the risk associated with competing with the nation's largest monopolies). What is more, SBC's view that collocation costs should not be recovered from collocated-services is completely at odds with any recognizable principle of economics, including the Commission's TELRIC principles.

Although the Coalition believes that the Analysis already minimizes collocation costs beyond a reasonable level, to prove just how groundless SBC's claims are we have recalculated the analysis eliminating collocation costs *entirely*. Of course, no entrant, no matter how efficient, could achieve collocation costs of zero, but the following Table assumes just such a result.

LINES	Monthly Loop (corrected)[29]	DS-1 Contract Length		
		12 Month	24 Month	36 Month
12	$152.66	$266.43	$221.15	$210.16
13	$165.37	$266.43	$221.15	$210.16
14	$178.08	$266.43	$221.15	$210.16
15	$190.79	$266.43	$221.15	$210.16
16	$203.50	$266.43	$221.15	$210.16
17	$216.21	$266.43	$221.15	$210.16
18	$228.92	$266.43	$221.15	$210.16
19	$241.63	$266.43	$221.15	$210.16
20	$254.34	$266.43	$221.15	$210.16
21	$267.05	$266.43	$221.15	$210.16
22	$279.76	$266.43	$221.15	$210.16
23	$292.47	$266.43	$221.15	$210.16
24	$305.18	$266.43	$221.15	$210.16

As the above Table shows, even the assumption of zero collocation costs does not materially change the conclusion – the economic crossover to digital service is approximately 20 lines. Although the crossover does decline as the customer's contract commitment increases, the impairment analysis should not limit CLECs to only those customers willing to sign long-term contracts. The market at issue – small businesses and residential customers – are not typically served with long term contracts and forcing CLECs to only offer such arrangements would effectively foreclose entry and competition for this customer segment.

SBC also claims that the Analysis failed to consider the declining nature of SBC's non-recurring charges. However, the Analysis already assumes the *most* efficient loop-migration arrangement possible by adopting the non-recurring costs of an electronic migration of the loop (such as is possible today, but only with UNE-P). This approach was used because the goal of the crossover analysis is to estimate the point at which it becomes efficient to migrate a customer to digital services where "hand-crafting" is the industry norm, and not an impairment imposed only on entrants.

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[29] While removing collocation costs from the Analysis, it was discovered that the original Analysis incorrectly included the monthly port costs in the Monthly Loop column. As explained in earlier Coalition Ex Partes, port costs should be removed to maintain the conservative assumption that the entrant's switch, backhaul, and interoffice transport costs are no higher than the switch and transport (no backhaul) costs of the ILEC. Unfortunately, these costs were inadvertently retained in earlier computations. Although the above Table has corrected the error, it does not materially change the crossover analysis. Without the correction, the crossover (assuming zero collocation costs) would be 19 (one-year contract), 16 (two-year contract), and 15 (three-year contract). The correct crossovers, however, are shown in the Table above.

Finally, SBC claims that the Coalition has offered no new evidence. According to SBC, the Commission has already reviewed evidence concerning the additional costs caused by manual provisioning and the Coalition has presented no new reason why the customer line cut-off should be increased.[30] It is this aspect of SBC's Ex Parte that is the most disturbing. The Coalition has clearly demonstrated that "hand-crafting" local service cannot viably support mass-market competition. We have rationally related this impairment to the number of analog lines serving the customer using a highly conservative analysis that both *underestimates* the direct economic disadvantage (as measured by cost) and has (for purposes of this discussion) *ignored* the other effects of manual provisioning on reliability, quality and volume. In addition, we have shown from actual market experience in New York and Texas the substantial differences in competitive activity made possible with access to ULS and UNE-P, which stands in stark contrast to the level of competitive activity where only UNE loops are offered. No other demonstration of impairment could be more compelling.

Sincerely,

Genevieve Morelli

cc: Jonathan Reel
Larry Strickling
Jake Jennings
Christopher Libertelli

30 SBC Ex Parte, page 6.